



CRC Memorandum

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THE GROWING DIFFERENCE BETWEEN STATE EQUALIZED VALUE AND TAXABLE VALUE IN MICHIGAN

In Brief

Proposal A of 1994 superimposed upon the property assessment system already in place, a modified acquisition value method of determining taxable value. Instead of applying the tax rate to annual assessments of property at 50 percent of true cash value, commonly referred to as state equalized value, it is applied to taxable value, in which increases on individual parcels of property that were not acquired during the tax year are limited to the lesser of five percent or inflation. The property assessment as of December 31, 1999, for taxes levied in 2000, marks the sixth year of operating under this system, providing an opportunity to examine the impact it has had on government finances and on providing relief to taxpayers.

For the 2000 tax year, the statewide taxable value was 84.6 percent of state equalized value. Local units of government and classes of property have been affected in varying degrees by this new system of assessment. In addition to examining those impacts, this paper will consider what the future might hold and will analyze some of the experiences of the modified value acquisition system in California.

Introduction

The property tax has long been a mainstay of Michigan local government finances. As the primary local funding source for local governments, the property tax has been a very visible tax and one of the most disliked taxes in public opinion polls. Despite the adoption of tax rate limitations and property tax credits over the years, taxpayers perceived little relief until adoption of Proposal A in 1994, which

placed a cap on individual taxable value growth each year for properties not sold during the year, along with restructuring school finance and reducing property tax rates on average by more than 30 percent. Six years of experience under this system permits examination of the impact this growth cap has had on state and local government finance and on providing relief to different types of taxpayers.

The Cap on Taxable Value

Calculation of Property Tax

Property taxes are calculated by multiplying a tax rate by a tax base. The total tax rate is the sum of the tax rates levied by several taxing jurisdictions. For instance, the tax rate for any single property is the sum of the tax rates levied by a city, village, or township, the county, a school district, the intermediate school district, and the state for the state education tax. Other taxes may be levied for community college districts, special tax authorities or districts, and any bond or debt millages levied by any of these jurisdictions. The property tax base represents the total of all real and personal property within a taxing jurisdiction not exempt from taxation. Property owned by government agencies, non-profit organizations, and property subject to another tax in lieu of the property tax is exempt from the general property tax.

Introduction of Cap on Taxable Value

Because the actual market value of property is determined only upon sale, governments use a method of assigning property values known as assessment. Michigan's Constitution requires that the assessed value of every property be a uniform proportion, not to exceed 50 percent, of the "true cash value," referred to as state equalized value (SEV). State law sets SEV at the constitutional maximum. Thus, the assessment process in Michigan involves determining "true cash value" and dividing it by two. The assessed values are equalized among the cities and townships within a county, and among the counties by the state tax commission to ensure uniformity throughout the state.

Proposal A superimposed a modified acquisition value method of determining the taxable value of property upon

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this property assessment system already in place. For property assessments as of December 31, 1994, and thereafter, annual increases in the taxable value (TV) of individual parcels of existing property are limited to the lesser of five percent or inflation.

When ownership of a parcel of property is transferred as defined by law, the parcel is reassessed "at the applicable proportion of current true cash value." Additions and modifications to existing property and new property are placed on the tax rolls at 50 per-

cent of current true cash value.

Assessors continue to record, and the state computes, the SEV of each parcel of property for purposes of assigning a taxable value upon transfer equal to 50 percent of the true cash value.

Six Years of Limited Growth in Taxable Value

The assessment as of December 31, 1999, for taxes levied in 2000, marked the sixth year of implementation of the modified acquisition value approach. During those six years, growth in taxable value has been held to the inflation rate, which has been less than the five percent limit each year.

Applicable Inflation Limit on Taxable Value Growth

1995	2.5%
1996	2.8%
1997	2.8%
1998	2.7%
1999	1.6%
2000	1.9%
2001	3.2%

Source: Michigan Department of Treasury, State Tax Commission

In such circumstances, the inflation rate does not automatically become the growth rate of taxable value. Because some property values grew at lower rates, they were unaffected by this cap. Transferred properties, additions, and modifications are not subject to these limits.

Statewide Difference

For the state as a whole, 2000 TV was 84.6 percent of 2000 SEV (See Chart 1). The taxation of property at SEV rather than TV would cause statewide property tax revenues to increase 18.2 percent. The divergence of SEV and TV, with TV used as the tax base, has resulted in a total statewide tax yield

in 2000 of about \$1.7 billion less than would have been the case had SEV been used as the tax base. The total statewide tax yield for the years 1995-2000 was about \$4.9 billion less than if the tax base had been SEV.

Difference by Class of Property

For purposes of equalizing assessments, Michigan property is classified into six classes: agricultural, commercial, industrial, residential, timber cutover, and developmental. Table 1 details the ratio of TV to SEV by class of property. By analyzing these ratios, it is possible to observe the impact the cap has had on each type of property.

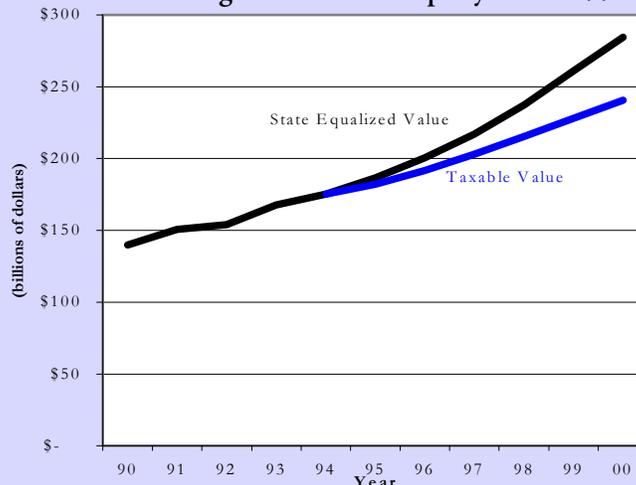
Agricultural, Timber Cutover, and Developmental Property. Owners of agricultural, timber cutover, and developmental properties are the great-

est beneficiaries of this new system of property assessment. Possibly because of low rates of turnover in ownership, these properties remain subject to the cap on assessments for longer periods, and thus develop greater gaps in the ratio of TV to SEV.

The modified acquisition value system served to lessen the role of these three classes of property in the total statewide tax. In 1994, these three classes of property constituted 4.2 percent of the total statewide tax base. In 2000, their taxable value constituted 3.3 percent, a reduction of about one-fifth.

Commercial and Industrial Property. Commercial and industrial property had the narrowest gaps of all classes of property. Even though these types of property remain closest to full as-

Chart 1
Growth in Michigan Statewide Property Value: 1990 - 2000



Source: Michigan Department of Treasury, State Tax Commission

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Table 1
Taxable Value and State Equalized Value by Class of Property

	<u>Percent of Total Property Value*</u>			<u>Ratio of Taxable Value to State Equalized Value</u>				
	<u>1994</u>	<u>2000</u>	<u>2000</u>	<u>Statewide Gap</u>	<u>Maximum Gap</u>		<u>Minimum Gap</u>	
	<u>SEV</u>	<u>TV</u>	<u>SEV</u>		<u>Percent</u>	<u>County</u>	<u>Percent</u>	<u>County</u>
Agricultural	3.9	3.1	3.8	69.7	47.5	Alger	92.5	Montmorency
Commercial	14.0	13.6	13.3	86.9	72.4	Luce	97.5	Tuscola
Industrial	7.4	6.8	6.2	93.4	71.4	Houghton	99.6	Midland
Residential	62.4	64.3	66.4	82.0	65.9	Luce	91.2	Midland
Timber Cutover	0.2	0.1	0.1	62.9	40.7	Manistee	100.0	Bay
Developmental	0.2	0.1	0.2	61.5	15.9	Ogemaw	100.0	Presque Isle
Total Real and Personal				84.6	68.2	Luce	94.6	Midland

* Personal property accounts for 12.0 percent of 1994 SEV; 11.9 percent of 2000 TV; and 10.1 percent of 2000 SEV.

Source: Michigan Department of Treasury, State Tax Commission.

assessment, they constitute a smaller percentage of the total statewide tax base than they did in 1994 (See Table 1). This reduction has been mitigated, however, by the higher tax rates paid by non-homestead properties under provisions of Proposal A.

Residential Property. The TV of residential property was 82 percent of SEV in 2000. Unlike the other classes of property, residential property constituted a larger portion of the total statewide tax base in 2000, when 64.3 percent of the TV was classified as residential property, than it did in 1994 (62.4 percent). That growth in the portion of the total tax base would have been even larger had SEV continued as the tax base. (Residential property was 66.4 percent of all SEV in 2000.)

This shift in tax burden was evident in 72 of Michigan's 83 counties. Kalamazoo County experienced the largest shift, with a 14.1 percentage point shift from non-residential property in 1994 to residential property in 2000. In only 11 counties did non-residential property constitute a larger percent of the total than it had in 1994. They are as follows:

	<u>Percentage Point Shift</u>
Dickinson	4.2
Lake	3.0
Delta	2.5
Alpena	1.3
Crawford	1.1
Branch	0.8
Antrim	0.7
Montmorency	0.6
Kent	0.5
Alcona	0.3
Grand Traverse	0.01

Local Government Difference

The Data

The change in relationship between TV and SEV has varied among individual counties (See Table 2 on pages 4 and 5), ranging from Midland County with TV equal to 94.6 percent of SEV to Luce County with TV equal to 68.2 percent of SEV. The ratio of TV to SEV for Michigan's five largest cities is as follows:

	<u>TV as a Percent of SEV</u>
Detroit	73.3
Grand Rapids	91.8
Warren	89.0
Flint	89.5
Lansing	90.5

(Detail for all cities and townships can be accessed on the CRC website at www.crcmich.org/.)

Local units that are experiencing new growth, additions to existing property, and rapid turnover of properties will have TV that is keeping pace with the growth in SEV. Conversely, local units with lower investment rates and slower turnover of properties will find the gap between SEV and TV growing larger every year. Growth in the difference between SEV and TV is not necessarily a sign of economic weakness, as property owners may simply be opting to maintain ownership of their properties.

Type of Unit

For purposes of comparison, Michigan counties were separated into two groups: urban and rural.¹ Based on this separation, the ratio of TV to SEV

¹ Separation was based on the metropolitan statistical areas defined by the U.S. Bureau of Census. The 25 urban counties include: Allegan, Bay, Berrien, Calhoun, Clinton, Eaton, Genesee, Ingham, Jackson, Kalamazoo, Kent, Lapeer, Lenawee, Livingston, Macomb, Midland, Monroe, Muskegon, Oakland, Ottawa, Saginaw, St. Clair, Van Buren, Washtenaw, and Wayne.

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Table 2
Michigan State Equalized Value and Taxable Value by County: 1994 and 2000
(millions of dollars)

Counties	1994 SEV			2000 SEV			2000 TV			Ratio of TV to SEV	
	Residential	Non-residential	Total	Residential	Non-residential	Total	Residential	Non-residential	Total	Residential	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	%	%
Alcona	293.6	90.3	383.9	464.1	153.8	617.9	380.3	118.9	499.2	82.0%	80.8%
Alger	108.7	41.1	149.8	201.1	61.6	262.6	148.7	53.4	202.1	74.0%	77.0%
Allegan	1,066.2	707.5	1,773.8	2,095.9	1,114.8	3,210.7	1,637.1	948.4	2,585.6	78.1%	80.5%
Alpena	296.3	178.4	474.7	463.4	278.2	741.6	389.6	247.8	637.4	84.1%	86.0%
Antrim	654.3	108.1	762.4	1,133.8	197.2	1,330.9	884.9	154.0	1,038.9	78.0%	78.1%
Arenac	199.2	97.4	296.6	333.9	119.4	453.3	269.3	102.6	371.9	80.7%	82.1%
Baraga	56.7	43.1	99.8	117.4	60.7	178.2	85.4	49.8	135.2	72.8%	75.9%
Barry	608.2	205.8	814.0	1,119.1	328.3	1,447.4	895.8	263.3	1,159.1	80.1%	80.1%
Bay	934.8	823.2	1,758.0	1,517.0	1,003.2	2,520.2	1,268.5	930.0	2,198.5	83.6%	87.2%
Benzie	345.0	62.5	407.5	703.7	104.4	808.1	509.3	81.9	591.2	72.4%	73.2%
Berrien	1,997.4	1,388.9	3,386.3	3,155.1	1,653.6	4,808.7	2,631.1	1,533.1	4,164.2	83.4%	86.6%
Branch	315.5	257.4	572.9	616.8	475.6	1,092.4	455.4	384.0	839.4	73.8%	76.8%
Calhoun	1,088.4	831.1	1,919.5	1,826.1	1,255.9	3,082.0	1,503.9	1,093.4	2,597.3	82.4%	84.3%
Cass	544.9	249.8	794.7	1,005.5	407.3	1,412.7	758.4	302.4	1,060.8	75.4%	75.1%
Charlevoix	625.0	222.1	847.1	1,162.8	308.0	1,470.8	895.7	271.1	1,166.8	77.0%	79.3%
Cheboygan	461.4	141.1	602.5	854.3	220.6	1,074.9	639.5	177.3	816.8	74.9%	76.0%
Chippewa	320.4	158.3	478.7	587.7	225.5	813.2	451.1	202.5	653.6	76.8%	80.4%
Clare	335.9	148.6	484.5	594.6	205.3	799.9	458.9	179.7	638.6	77.2%	79.8%
Clinton	635.3	329.5	964.8	1,127.2	488.5	1,615.7	974.0	412.6	1,386.5	86.4%	85.8%
Crawford	197.6	95.7	293.3	315.4	141.2	456.6	256.0	130.1	386.1	81.2%	84.6%
Delta	323.4	196.1	519.5	612.9	337.0	950.0	455.6	306.7	762.3	74.3%	80.2%
Dickinson	251.2	182.2	433.4	383.9	303.7	687.6	336.1	289.2	625.2	87.5%	90.9%
Eaton	1,000.4	617.2	1,617.7	1,611.0	919.8	2,530.7	1,410.8	803.4	2,214.2	87.6%	87.5%
Emmet	829.9	276.2	1,106.1	1,619.6	408.9	2,028.5	1,321.0	344.1	1,665.1	81.6%	82.1%
Genesee	3,669.2	2,396.7	6,065.9	6,152.5	3,215.6	9,368.1	5,186.7	2,970.8	8,157.6	84.3%	87.1%
Gladwin	337.8	81.9	419.7	614.0	110.3	724.3	482.8	97.3	580.1	87.6%	80.1%
Gogebic	146.9	108.3	255.2	270.4	117.7	388.1	192.8	107.4	300.2	71.3%	77.4%
Grand Traverse	1,121.4	524.0	1,645.3	2,091.6	943.6	3,035.1	1,666.0	778.8	2,444.8	79.7%	80.5%
Gratiot	206.6	285.3	491.9	362.5	431.8	794.3	285.5	337.8	623.3	78.7%	78.5%
Hillsdale	369.9	279.9	649.8	666.1	454.0	1,120.2	532.5	359.3	891.8	79.9%	79.6%
Houghton	206.6	107.3	313.8	397.0	162.2	559.2	296.7	132.9	429.6	74.7%	76.8%
Huron	420.0	470.9	890.9	730.1	666.5	1,396.6	566.7	551.5	1,118.3	77.6%	80.1%
Ingham	2,571.0	1,610.8	4,181.9	3,837.7	2,323.4	6,161.1	3,376.9	2,066.8	5,443.8	88.0%	88.4%
Ionia	389.0	267.2	656.2	735.6	426.5	1,162.2	585.8	340.4	926.2	79.6%	79.7%
Iosco	436.8	145.1	582.0	687.7	202.0	889.7	570.7	184.9	755.6	83.0%	84.9%
Iron	118.2	101.0	219.2	219.8	124.6	344.4	160.9	112.1	273.0	73.2%	79.3%
Isabella	371.6	295.5	667.2	656.4	479.2	1,135.6	543.4	382.0	925.3	82.8%	81.5%
Jackson	1,299.8	724.4	2,024.2	2,461.8	1,172.9	3,634.7	1,857.9	919.7	2,777.6	75.5%	76.4%
Kalamazoo	2,356.0	1,624.3	3,980.3	3,819.2	2,266.1	6,085.3	3,277.9	2,105.6	5,383.5	85.8%	88.5%
Kalkaska	201.1	217.2	418.3	384.7	202.9	587.5	300.1	182.6	482.7	78.0%	82.2%

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Counties	1994 SEV			2000 SEV			2000 TV			Ratio of TV to SEV	
	Residential	Non-residential	Total	Residential	Non-residential	Total	Residential	Non-residential	Total	Residential	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	%	%
Kent	6,049.1	3,996.4	10,045.5	9,721.6	6,191.3	15,912.9	8,595.0	5,803.3	14,398.3	88.4%	90.5%
Keweenaw	32.2	8.5	40.7	71.9	12.4	84.3	52.2	10.6	62.8	72.6%	74.5%
Lake	170.0	42.7	212.7	331.3	86.0	417.4	235.4	70.5	305.9	71.0%	73.3%
Lapeer	950.5	398.1	1,348.6	1,947.8	648.6	2,596.5	1,502.0	507.0	2,009.0	77.1%	77.4%
Leelanau	758.5	169.0	927.5	1,413.3	267.1	1,680.4	1,062.2	203.6	1,265.8	75.2%	75.3%
Lenawee	918.4	617.6	1,536.0	1,723.2	975.6	2,698.8	1,376.4	810.5	2,186.9	79.9%	81.0%
Livingston	2,382.9	695.4	3,078.3	4,715.8	1,295.9	6,011.7	3,928.9	1,121.4	5,050.4	83.3%	84.0%
Luce	55.9	18.4	74.3	131.7	31.7	163.3	86.8	24.6	111.4	65.9%	68.2%
Mackinac	253.0	185.9	438.9	458.9	283.5	742.4	348.9	221.5	570.4	76.0%	76.8%
Macomb	9,845.7	4,856.0	14,701.7	17,087.6	7,229.3	24,316.9	14,304.2	6,795.1	21,099.3	83.7%	86.8%
Manistee	280.7	195.3	476.0	568.9	242.3	811.2	418.5	213.1	631.6	73.6%	77.9%
Marquette	550.6	356.5	907.1	875.6	442.4	1,318.0	724.4	417.7	1,142.1	82.7%	86.7%
Mason	345.5	424.0	769.5	614.4	500.6	1,115.0	488.1	467.7	955.8	79.4%	85.7%
Mecosta	359.5	206.6	566.1	631.7	288.9	920.6	511.9	244.6	756.5	81.0%	82.2%
Menominee	187.1	118.2	305.3	322.4	149.2	471.7	258.2	132.8	390.9	80.1%	82.9%
Midland	1,025.1	1,455.4	2,480.6	1,501.0	1,609.0	3,110.1	1,368.3	1,574.7	2,943.1	91.2%	94.6%
Missaukee	137.7	121.1	258.7	275.7	147.6	423.3	213.0	124.0	336.9	77.3%	79.6%
Monroe	1,545.8	2,029.2	3,574.9	2,771.9	2,445.4	5,217.2	2,258.9	2,257.6	4,516.5	81.5%	86.6%
Montcalm	458.1	298.6	756.7	824.6	498.9	1,323.5	658.1	394.9	1,052.9	79.8%	79.6%
Montmorency	179.8	71.9	251.7	314.4	99.0	413.4	234.7	96.7	331.4	74.6%	80.2%
Muskegon	1,430.2	713.6	2,143.8	2,407.2	1,068.3	3,475.5	1,993.5	975.9	2,969.4	82.8%	85.4%
Newaygo	423.1	209.2	632.3	823.5	311.3	1,134.8	607.2	247.6	854.8	73.7%	75.3%
Oakland	20,647.0	10,533.3	31,180.3	35,706.7	16,730.7	52,437.4	29,612.5	14,758.3	44,370.8	82.9%	84.6%
Oceana	328.8	122.3	451.1	593.5	187.2	780.6	456.1	159.9	616.0	76.9%	78.9%
Ogemaw	274.8	117.5	392.3	521.4	160.5	681.9	384.2	130.1	514.3	73.7%	75.4%
Ontonogon	59.4	73.8	133.2	104.6	89.8	194.4	79.8	73.4	153.2	76.3%	78.8%
Oscola	164.8	176.6	341.4	337.0	241.5	578.5	252.6	200.3	452.9	74.9%	78.3%
Oscoda	129.9	46.7	176.6	248.2	65.7	313.9	182.5	56.6	239.0	73.5%	76.1%
Oshtemo	341.4	265.3	606.7	622.8	405.1	1,027.9	505.1	358.8	863.8	81.1%	84.0%
Ottawa	2,762.8	1,488.1	4,250.8	4,832.1	2,349.2	7,181.4	4,141.6	2,051.2	6,192.8	85.7%	86.2%
Presque Isle	202.4	113.8	316.2	354.4	143.0	497.4	282.4	117.2	399.6	79.7%	80.3%
Roscommon	536.3	100.7	637.0	909.3	148.3	1,057.6	717.7	118.4	836.1	78.9%	79.1%
Saginaw	1,771.6	1,277.4	3,048.9	2,682.7	1,688.3	4,371.0	2,343.6	1,593.8	3,937.4	87.4%	90.1%
St. Clair	1,799.5	1,599.7	3,399.2	3,232.5	2,085.7	5,318.2	2,653.0	1,879.5	4,532.5	78.5%	85.2%
St. Joseph	491.8	393.9	885.7	898.7	666.6	1,565.3	697.0	527.0	1,224.0	67.9%	78.2%
Sanilac	384.9	344.8	729.7	689.6	570.6	1,260.3	541.5	421.5	963.1	78.9%	76.4%
Schoolcraft	86.1	61.3	147.5	192.2	78.8	270.9	130.5	69.6	200.0	82.1%	73.8%
Shiawassee	562.4	332.5	894.9	1,012.1	458.5	1,470.6	798.9	399.7	1,198.6	77.6%	81.5%
Tuscola	375.7	375.3	750.9	716.7	529.3	1,246.0	556.5	432.5	989.0	77.6%	79.4%
Van Buren	726.5	459.2	1,185.8	1,320.4	626.1	1,946.5	1,055.8	555.7	1,611.5	80.0%	82.8%
Washtenaw	3,957.1	2,760.3	6,717.5	7,047.9	3,903.5	10,951.3	6,100.8	3,558.6	9,659.4	86.6%	88.2%
Wayne	17,655.0	11,276.1	28,931.1	29,059.9	15,332.3	44,392.2	22,819.9	14,476.7	37,296.6	78.5%	84.0%
Wexford	262.6	171.1	433.7	502.4	241.1	743.5	400.7	214.5	615.3	79.8%	82.8%
State Total	\$109,571.7	\$65,968.6	\$175,540.3	\$188,828.7	\$95,598.2	\$284,426.8	\$154,838.6	\$85,878.6	\$240,717.2	82.0%	84.6%

was compared by type of unit (See Table 3). These data show that charter townships have the highest ratio of TV to SEV, followed by cities and general law townships.

Charter Townships. Generally located on the fringe of Michigan’s metropolitan areas where new development has focused in recent times, charter townships have the highest ratio of TV to SEV. There is little difference in the ratio of charter townships whether they are located in urban or rural counties.

Cities. Cities show little difference in the relationship between TV and SEV, whether in urban or rural counties.

General Law Townships. General law townships have the greatest disparity between TV and SEV. This relates to two factors. First, as a whole, the property value of general law townships grew faster than in other municipalities. Second, as indicated by the difference in ratios between urban and rural general

<u>Type of Unit</u>	<u>In Rural Counties</u>	<u>In Urban Counties</u>	<u>Statewide</u>
Charter Townships	86.0	87.5	87.5
Cities	86.4	86.3	86.3
General Law Townships	77.7	81.8	80.0
Counties	79.7	85.7	84.6

law townships, townships have a high concentration of agricultural property, which has developed the largest margins between TV and SEV.

Geographic Patterns

The larger urban areas of the state have taxable values closer to their true cash values than do the rural areas. This has implications at both the local and state levels. At the local level, units of government in rural areas can expect to be confronted by constrained property tax revenues to higher degrees than will be the case for urban areas. At the state level, this geographic shift has implications on two aspects of state finances:

- 1) The **State Education Tax** – This shift results in a smaller portion of the tax burden for this six-mill, statewide property tax being paid by rural areas of the state compared to urban areas.
- 2) The **School Aid Fund** – Local school districts levy a local operating tax on non-homestead property to fund a portion of their foundation allowances (their revenues per pupil). The School Aid Fund contributes the balance. A lower ratio of TV to SEV results in fewer dollars raised locally and the state must contribute a larger amount, reducing the amount of state dollars that could be used to support a higher foundation allowance.

The Future

The different growth rates in TV and SEV arising from the cap mechanism are likely to narrow and eventually disappear over time and the percentage difference between TV and SEV should stabilize. (The diverging lines representing SEV and TV in **Chart 1** will assume more parallel paths.) As properties are sold and new properties are placed on the tax rolls, their TV is increased to the SEV for purposes of the tax levy calculations for the new property owners, the so-called “pop-up” tax. Eventually, the pop-up factor will be large enough to offset the limits on TV increases. The average turnover rate of property (in years) is a key factor in determining how long it will take for this to happen, but it is not the only factor. Generally, the following relationships hold:

- The shorter the turnover period

of property sales, the sooner the stabilization of the ratio of TV to SEV will occur. Areas with relatively little sales activity would take longer to stabilize than areas with considerable in- and out-migration and the associated increased frequency of property sales.

- The greater the proportion of new property, the faster the stabilization of the ratio of TV to SEV will occur. This factor is important in areas experiencing significant development of new properties. In addition to stabilizing more quickly, the percentage difference between TV and SEV will be less in such areas.
- The smaller the difference between TV and SEV annual percentage growth, the faster the stabilization of the ratio of TV to SEV will occur. Areas with relatively slowly growing

property values would stabilize before areas experiencing rapid increases in property prices.

Short-Term Trends. Because the gap between TV and SEV is relatively small for any given property in the early years of the cap, the pop-up factor will add correspondingly small amounts to TV. In later years, when properties that had not been on the market are transferred the pop up effect could be very significant.

Longer-Term Trends. While little empirical evidence exists on the average sales turnover of property, it seems likely that it lies somewhere between seven and twelve years. Simulation calculations performed by CRC suggest that with a seven-year sales turnover period, it would take nearly 20 years for the gap to stabilize. However,

most of the gap would have opened by the end of ten years. With a 12-year

cycle, it takes nearly 30 years for the gap to stabilize, but most of the gap would

have opened up by the end of 15 years.

Appendix: California's Experience with Proposition 13

Proposition 13 of 1978

In June 1978, California voters led the era of taxpayer revolts by amending the California Constitution. This initiative, known as Proposition 13, followed many years of rapidly rising property taxes, averaging 11.5 percent per year from Fiscal Year (FY) 1968 to FY 1972. As in Michigan, efforts had been made to limit tax rate growth, with little effect on escalating taxes.

The modified acquisition value system adopted by Michigan voters in 1994 has many of the same characteristics of Proposition 13. California property taxes are limited to one percent of "full cash value." Full cash value is defined as the assessed valuation as of the 1975-76 tax year or, "thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment." The assessment "may reflect from year to year the inflationary rate not to exceed 2 percent for any given year."

A major difference between the systems adopted in California and Michigan is the method of calculating the full cash value. In Michigan, the modified acquisition value system was imposed upon an established system of calculating and equalizing property values. While taxable value serves as the tax base, city, township, and county assessors continue to determine SEV. California's method of calculating market value prior to 1978 was arguably not as strong, so there was little reason to cling to it after adoption of Proposition 13. In California, the sale price serves as the full cash value, unless there is reason to

think the transfer was less than an arm's length transaction.

Assessed and Market Values

Because California has adopted this method of determining full cash value, tracking the differences between the market value and the assessed value for taxation purposes is more difficult in California than in Michigan. The Public Policy Institute of California, in a 1998 report, *Proposition 13 in Recession and Recovery*, looked at the disparity between assessed values and market values in two counties: Los Angeles and San Mateo. Their findings show that 1996 assessed values were about 71 percent of market values in Los Angeles County; 61 percent in San Mateo County.

These two counties are largely urban or suburban in nature, with very little agricultural property. Because agricultural property transfers less frequently than residential, commercial, or industrial property, it is likely that the overall gap in the statewide ratio of assessed value to market value would be wider than that of these two counties.

Lessons Learned

California offers some lessons to Michigan in considering the effects of a modified value acquisition system on state and local government finances in addition to examining growth in the gap between assessed value and market value.

Differences in Assessed Value of Similar Properties. Californians have struggled with the effect that a modified value acquisition system has on

the taxation of similar properties. Two neighboring properties, similar in every way, can have very different tax bases based solely on the last date of transfer. For that reason, Proposition 13 was labeled a "welcome stranger" system, because newcomers to an established community are "welcome" in anticipation that they will contribute a larger percentage of support for local government than the settled neighbors.

In 1992, a challenge asserting that the acquisition-value system violates the Equal Protection Clause of the U.S. Constitution reached the U.S. Supreme Court. In *Nordlinger v. Hahn*, (505 U.S. 1), the court upheld the California system, because it "rationally" furthers a legitimate state interest. The court said, "The state legitimately can conclude that a new owner, at the point of purchasing his property, does not have the same reliance interest warranting protection against higher taxes as does an existing owner who is already saddled with his purchase and does not have the option of deciding not to buy his home if taxes become prohibitively high." The court also opined that a state has a rational interest in neighborhood preservation, continuity, and stability, and that Proposition 13's system of "locking in" lower tax assessments contributed to such preservation.

Stable Revenue Flows for Local Governments. Proposition 13 provides California local governments greater predictability and certainty of revenue flows than had existed prior to its adoption. A modified value acquisition system creates a reservoir of untapped tax base that can even out rev-

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enue flows during a recession. Because properties remain subject to the capped value until ownership changes and the tax base reverts to the market value, the year to year growth in market value of the properties becomes less significant than the number of properties that change ownership.

California experienced a prolonged recession from 1991 to 1995. Even with property values falling as much as 30 percent in some locations, the property tax yield and local government revenues did not suffer because of the reserve value created by this system.

While the rate of growth for SEV accelerates and decelerates corresponding to business cycles, TV grows at a steady rate because new developments and property transfers cause the value of properties to pop-up. The ability of taxable value to grow even while SEV is decelerating is referred to as a reservoir of untapped tax base (illustrated in Chart 2). Much as a rainy day fund provides additional funds, allowing a unit of government to avoid cuts in services during economic slowdowns, this reservoir of untapped tax base provides a stable source of revenues during economic slowdowns.

Predictable Property Tax Burden for Taxpayers. The other side of having

a stable revenue source for local governments, is the predictable tax burden a modified acquisition value system creates for taxpayers. In California, taxpayers are certain that the property tax burden will grow no faster than two percent per year. (Tax burdens in Michigan can grow no faster than five percent per year as a result of assessments; rate changes can cause greater increases.) Thus, property owners can calculate the maximum TV into the future.

Exemptions. Proposition 13, as

amended, provides several exemptions from the reassessment provision. Homeowners over the age of 55 who sell their principal residences are permitted to carry their previous base-year assessments with them to replacement residences of equal or lesser value. The law requires these moves to be within the same county, but a number of counties have enacted reciprocity provisions. Additionally, a property does not return to full cash value when a principal residence is transferred from parents to children.

Chart 2
Revenue Reservoir Created by the Modified Value Acquisition System

